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IN THE

Supreme Court of the United States

STONERIDGE INVESTMENT PARTNERS, LLC,
Petitioner,

v.

SCIENTIFIC-ATLANTA, INC. AND MOTOROLA, INC.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

BRIEF OF THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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INTEREST OF *AMICUS CURIAE*[1]

The Chamber of Commerce of the United States of America ("Chamber") is the world's largest business federation. The Chamber's underlying membership includes more than three million companies and professional organizations of every size, in every industry sector, and from every region of the country. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files *amicus curiae* briefs in cases that raise issues of concern to the nation's business community, such as cases involving the federal securities laws, including *Tellabs, Inc.* v. *Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499 (2007), and *Dura Pharms., Inc.* v. *Broudo*, 544 U.S. 336 (2005).

"Scheme" liability is nothing but a label in search of a cause of action. In reality, it is aiding and abetting liability disguised behind a new name. The Chamber has a vital interest in the "scheme" liability theory. The "scheme" liability label, which emerged after this Court and Congress rejected aiding and abetting liability in private § 10(b) actions, has been extended to commercial counterparties involved with an issuer merely through a commercial or financial transaction. It has no effective limiting principle, which is reason enough to reject the theory. *Santa Fe Indus.*,

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[1] Pursuant to this Court's Rule 37.6, *amicus curiae* states that no counsel for any party authored this brief in whole or in part, and no person or entity other than *amicus curiae* made a monetary contribution to the preparation or submission of the brief.

Pursuant to Rule 37.3, *amicus curiae* states that petitioner and respondents have consented to the filing of this brief. Petitioner has filed with the Clerk of the Court a letter granting blanket consent to the filing of amicus briefs, and a letter reflecting the consent of respondents to the filing of this brief has been filed with the Clerk.

Inc. v. *Green*, 430 U.S. 462, 478 (1977) (rejecting § 10(b) claims that "could not be easily contained").

"Scheme" liability would put American companies, including the Chamber's members, at two tremendous competitive disadvantages. First, American issuers of securities would have to price their commercial transactions to reflect the substantial added risk of liability for their counterparties. Second, and even more important, to avoid litigation risk, both domestic and foreign companies would have significant incentives to do business with companies listed on foreign exchanges, or with private companies. The Chamber's members would prefer that business choices be based on factors like price, efficiency, quality, and service, rather than litigation risk.

INTRODUCTION AND SUMMARY OF ARGUMENT

Although expanding the implied § 10(b) action to cover "scheme" liability suffers from an aggregation of flaws, this brief focuses on two points of particular concern to the business community. First, the standard of liability under § 10(b) should be workable, predictable, and consistently applied so that businesses can plan their affairs with reasonable certainty. "Scheme" liability is wholly unworkable in implied § 10(b) actions. Accordingly, the Chamber submits that the proper standard is as follows: a commercial counterparty is liable under § 10(b) for deceptive "conduct" only when it has a duty to disclose to the issuer's shareholders. This standard follows this Court's precedent and is based on well-understood, time-honored concepts that lower courts can readily apply in a predictable manner.

Second, in order to provide much-needed guidance to lower courts and the business community, the Court should not merely decide the narrow question of the proper definition of the term "deceptive," but instead should recognize that the "scheme" liability theory would fundamentally alter many traditional elements of the implied cause of action in ways

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that contradict both the statute and this Court's precedent. Implied causes of action should not be interpreted in ways that contradict or nullify legislative decisions. The expansion of the § 10(b) implied cause of action through "scheme" liability would both override limits on the express causes of action that Congress created and nullify Congress's repeated decisions that only the SEC can sue for the conduct covered by "scheme" liability.

Moreover, "scheme" liability contradicts *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), on reliance and contradicts the Private Securities Litigation Reform Act of 1995 ("PSLRA") on loss causation. These doctrines are essential means of providing reasonable limitations on liability and the Court should make clear that the "scheme" liability theory is simply untenable because it eviscerates such limitations.

ARGUMENT

I. "SCHEME" LIABILITY IS IMPROPERLY DERIVATIVE AND UNWORKABLE.

The question before this Court is whether to recognize "scheme" liability as a legitimate implied private cause of action under § 10(b). The question presented in the *amici* brief of 32 state attorneys general offers a representative definition of "scheme" liability as a theory, *i.e.*,

> *shareholders can recover damages* from actors who, acting with the requisite intent to deceive, actively engage in conduct that has the principal purpose and effect of creating a false appearance of fact in furtherance of a scheme to defraud the securities market, *even when the actor has made no false statement or omission and otherwise owes no fiduciary duty to the shareholders.*

Brief of Ohio, et al. ("Ohio Br."), at iii (emphasis added).

Petitioner, its amici, and lower courts have proposed an array of "scheme" liability standards, all of which share three common threads: the use of verbs that are synonymous with aiding and abetting or conspiracy; the intervening steps between the defendant's conduct and the issuer's statements that harmed the plaintiff; and the complete absence of a workable limiting principle. By contrast, the test this Court has repeatedly announced for § 10(b) liability for conduct—the existence of a duty to disclose by the specific defendant—has well-established contours and a fixed relationship to the existing elements of the private right of action.

A. Like Aiding-And-Abetting, "Scheme" Liability Is Derivative Of The Issuer's Conduct.

Petitioner asks this Court to find liability where defendants

> engaged in their own deceptive conduct in transactions with a public corporation *for the purpose and effect* of *creating* a false appearance of material fact that *enabled* the publication of artificially inflated *financial statements by the public corporation.*

Pet. Br. at *i* (emphases added). "Scheme" liability for a non-speaking defendant, like aiding-and-abetting, is purely derivative from the issuer's statements. Consider the words used by petitioner and *amici* to describe the conduct giving rise to "scheme" liability: "causing false financial statements to be published," *id.* at 22; *see also id.* at 30; Ark. Br. at 13, 14, "furthering the fraudulent scheme," Pet. Br. at 14, "participation" in a "scheme," *id.* at 14, 15, and "conspir[ing]" or "inducing" wrongdoing by the issuer, Prof. Adams Br. at 11, 17. These are simply ways of saying "aiding and abetting" or "conspiring" without using those words. *See Central Bank*, 511 U.S. at 181, 184 ("substantial assistance" or "knowing participation"); 15 U.S.C. § 78t(e). *See also Salinas* v. *United States*, 522 U.S. 52, 65 (1997) (conspiracy requires "adopt[ing] the goal of furthering or facilitating the criminal endeavor"). "Allegations of

'assisting,' 'participating in,' 'complicity in' and similar synonyms . . . all fall within the prohibitive bar of *Central Bank*." *Shapiro* v. *Cantor*, 123 F.3d 717, 720 (2d Cir. 1997). If anything, "scheme" liability is more expansive than aiding and abetting. Mere "participation" in a scheme that has some "effect" is easier to plead and prove than "substantial assistance."

Petitioner and its *amici* effectively admit the derivative essence of "scheme" liability. They admit that reliance and causation are satisfied in "scheme" cases not by reference to the conduct of a commercial counterparty such as respondents—whose conduct was unknown to the market—but rather because the issuer's "financial statements caused the price of [its] stock to be inflated and the purchasers of the stock were accordingly damaged." Pet. Br. at 38. *See also* Regents Br. at 16 (seeking damages for "falsifying the financial statements of a public company"). Decisions adopting "scheme" liability also have necessarily premised reliance and causation on the statements of the issuer rather than the unreported conduct of the counterparty. *See, e.g.*, *Simpson* v. *AOL TimeWarner Inc.*, 452 F.3d 1040, 1050-52 (9th Cir. 2006) ("the scheme [to defraud would not] be complete until the misleading information is disseminated into the securities market"), *petition for cert. filed*, 75 U.S.L.W. 3236 (U.S. Oct. 19, 2006) (No. 06-560); *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 509-10 (S.D.N.Y. 2005) (purpose and effect of scheme was "to allow Parmalat to make such misrepresentations").

The very "purpose and effect" test is derivative. To avoid liability for acting recklessly, the counterparty is expected to investigate the "purpose" and accounting policies of the issuer. Moreover, the "effect" also depends on further action by an issuer: if the issuer has a change of heart and accounts correctly for the transaction, the conduct and intent of the commercial counterparty are precisely the same—but there would be no improper effect and thus no "scheme" liability.

B. Scheme Liability Is Unworkable And Uncertain.

Central Bank held that liability under § 10(b) is "'an area that demands certainty and predictability.'" 511 U.S. at 188 (quoting *Pinter* v. *Dahl*, 486 U.S. 622, 652 (1988)). "Scheme" liability, however, would create a vague and unprincipled standard of private civil liability easily manipulated by plaintiffs' counsel with the benefit of hindsight. Every case of "scheme" liability would turn on post-hoc allegations of scienter, here called "purpose." As *Central Bank* held, the uncertainty created when a claim can be based entirely on alleged scienter drives up the costs of numerous legitimate transactions, and eliminates some altogether. *See* 511 U.S. at 188-89. Courts that have embraced "scheme" liability have inevitably allowed claims based on transactions that may well be legitimate. *See, e.g.*, *Parmalat*, 376 F. Supp. 2d at 504 n.160 (deceptive act allegation sustained even though bank merely may have accepted "valid receivables"); *In re Parmalat Secs. Litig.*, 414 F. Supp. 2d 428, 435 n.31 (S.D.N.Y. 2006) (deceptive act allegation sustained even though bank legitimately may have been exposed to "significant risk"). "Scheme" liability thus fosters judicial "decisions 'made on an ad hoc basis, offering little predictive value.'" *Central Bank*, 511 U.S. at 188 (quoting *Pinter*, 486 U.S. at 652).

The goals of the securities laws are ill served when large settlements are paid because of uncertainty. Rather, businesses need clear and understandable rules to follow. *See Pinter*, 486 U.S. at 654 n.29 (rejecting liability for "those who are only tangentially involved with" a securities transaction, because if "the test produces unpredictable results, it risks over-deterring" lawful activities). "Scheme" liability is the antithesis of certainty. Among other things, a counterparty has no ability to audit or dictate accounting decisions made by the issuer's management and auditors. Moreover, business transactions are often subject to complex, changing, or

inherently subjective accounting rules.[2] In hindsight, it is easy to use labels such as "round-tripping" to suggest that a transaction had no proper purpose, even though "[t]he mere existence of reciprocal dealing does not suggest 'round-tripping.' Indeed, it is a common, legitimate, and perhaps useful business practice . . . ." *Teachers Ret. Sys.* v. *Hunter*, 477 F.3d 162, 178 (4th Cir. 2007). *See also Tellabs*, 127 S. Ct. at 2511 (noting distinction between legitimate and illegitimate forms of "channel stuffing").[3]

Unlike a company's own securities disclosures, even large commercial transactions may often be negotiated by personnel who are not versed in accounting principles. *See Nordstrom, Inc.* v. *Chubb & Son, Inc.*, 54 F.3d 1424, 1435-36 (9th Cir. 1995) (distinguishing between "directors and officers, who – unlike the public relations or personnel departments – are necessarily aware of the requirements of SEC regulations and state law and the 'danger[s] of misleading buyers and sellers'"). Requiring a business to monitor its counterparty's accounting in every commercial transaction will greatly expand costs and litigation risk. "'The hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences.'" *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 748 (1975) (quoting *Ultramares Corp.* v. *Touche*, 174 N.E. 441, 444 (N.Y. 1931) (Cardozo, J.)).

As Treasury Secretary Paulson testified, private civil "scheme" liability "would create a very uncertain legal environment for all the individuals and all the public

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[2] "GAAP is not a set of rigid rules ensuring identical treatment of identical transactions, but rather characterizes the range of reasonable alternatives that management can use." *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1421 n.10 (3d Cir. 1997) (Alito, J.).

[3] Similarly, "certain contracts may be legitimately backdated." *SEC* v. *Solucorp Indus., Ltd.*, 197 F. Supp. 2d 4, 11 (S.D.N.Y. 2002).

companies that deal with public companies" and would be "ultimately harmful to our economy." *The State of the International Financial Services System: Hearing Before the H. Fin. Servs. Comm.*, 110th Cong. (2007), *reprinted by* Fed. News Serv. *See also* Comm'n on the Regulation of U.S. Capital Mkts. in the 21st Century, *Report and Recommendations* 90-91 (Mar. 2007) ("*Final Report*") (opposing "scheme" liability).[4] In particular, foreign companies would have a strong reason not to do business with American public companies. As *The Economist* stated: "An unfavorable ruling [in *Stoneridge*] would send a chill through boardrooms, and not only in America . . . [because] it would no longer even be necessary to issue shares in the United States to incur securities liability . . . . Any firm, anywhere, doing business with American companies would have to live with the risk that the transaction could later be portrayed as fraudulent or deceptive. And painting such pictures is what trial lawyers do best." *The Stoneridge Showdown*, Economist, Jun. 14, 2007, at 84.[5]

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[4] Indeed, two current SEC Commissioners have opposed "scheme" liability in public testimony because it has proved unworkable, creates "a real danger in chilling ongoing transactions," and will harm the "competitiveness of our economy." *A Review of Investor Protection and Market Oversight with the Five Commissioners of the Securities and Exchange Commission: Hearing Before the H. Comm. on Fin. Servs.*, 110th Cong. (2007), *reprinted by* Fed. News Serv. (Statements of Paul S. Atkins and Kathleen L. Casey, Commissioners of the Securities Exchange Commission).

[5] *See also* Professor Rüdiger von Rosen, *Transatlantic Relations in Danger*, Boersenzeitung, June 28, 2007, at 14 (The President of the Deutsches Aktieninstitut, a business organization of German companies, explaining that "legal certainty and forseeability in transatlantic business could suffer a severe setback if [Petitioners are] successful," and could lead to a "wave of lawsuits" and "incalculable risks of class actions in the United States" that would require German companies doing business with listed companies in the U.S. "to examine the possibility of a false booking in every transaction, which is practically impossible." This could result in "transatlantic business relations [being] burdened by significant additional

C. Deceptive Conduct By A Commercial Counterparty Requires A Duty To Disclose.

As we have shown, "scheme" liability attempts to hold one defendant that did not speak to investors, often a commercial counterparty, liable for the issuer's misstatement. *Supra*, at 4-5. A well-developed body of law already exists, however, under which a defendant who engages in conduct, but neither makes a false or misleading statement to the market nor engages in market manipulation, can be sued for conduct "*only* where [a] duty to disclose arises from [a] specific relationship between two parties." *Central Bank*, 511 U.S. at

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costs from misunderstood investor protection."); Astrid Maier, *German Companies Threatened By New Risks in the United States*, Fin. Times Deutchland, June 8, 2007, at 10m ("there will be a whole new door opened for damages actions" that "'would mean that each and every engagement must be thoroughly examined' . . . In particular small and medium sized companies would be burdened with significant legal costs"); *Interim Report of the Committee on Capital Markets Regulation* 11, 71 (Nov. 30, 2006) ("*Interim Report*") ("Foreign companies commonly cite the U.S. class action enforcement system as the most important reason why they do not want to list in the U.S. market."); Michael Bloomberg & Charles Schumer, *Sustaining New York's and the US' Global Financial Services Leadership* ii (Jan. 2007) ("the legal environments in other nations, including Great Britain, far more effectively discourage frivolous litigation" while "the prevalence of meritless securities lawsuits and settlements in the U.S. has driven up the apparent and actual cost of business—and driven away potential investors"); Jonathan Macey, *What Sarbox Wrought*, Wall St. J., Apr. 7, 2007, at A9 ("All of a sudden it is no longer fashionable to be a U.S. public company: It's for suckers who can't access the piles of sophisticated 'global' capital available elsewhere. . . . If the U.S. is to regain its former position in the world capital market, much more will have to be done. Massive litigation risk remains . . . .") Ian Swanson, *Foreign Executives Press For Reform Of Litigation in United States*, The Hill, May 17, 2007, at 11; ("litigation is a greater disincentive to doing business in the U.S. than fears that a protectionist Congress might impose new barriers to foreign trade and investment"); Alan Beattie, *London Named Top Financial Centre*, Fin. Times, June 12, 2007, at 6 (the United States has been disadvantaged because of its "litigious and apparently arbitrary culture of regulation and policy").

180 (emphasis added) (citing *Chiarella* v. *United States*, 445 U.S. 222, 228 (1980)). *See Chiarella*, 445 U.S. at 230 (liability for nondisclosure "is premised upon *a duty to disclose arising from a relationship of trust and confidence between the parties to a transaction.*") (emphasis added); *id.* at 233 ("Formulation of such a broad duty, which *departs radically from the established doctrine that duty arises from a specific relationship between two parties*, should not be undertaken absent some explicit evidence of congressional intent") (emphasis added).

Unlike "scheme" liability, a duty to disclose is individual, not derivative, and provides an objective, workable, bright-line standard that looks at the relationship between the parties rather than the defendant's subjective intent. *See, e.g., id.* at 232-33 ("No duty could arise from petitioner's relationship with the sellers of the target company's securities, for petitioner had no prior dealings with them. He was not their agent, he was not a fiduciary, he was not a person in whom the sellers had placed their trust and confidence. He was, in fact, a complete stranger . . . [to] the sellers."). Duty to disclose is a legal question, and there is well-developed law to guide businesses concerning when such a duty exists. *Id.* at 227 (duty to disclose standard "is not a novel twist of the law").

Petitioner and its *amici* incorrectly argue that there is no requirement of a duty to disclose when a non-speaking defendant engages in affirmative "conduct." Pet. Br. at 28; Brief of Change to Win & the CtW Inv. Group ("CTW Br."), at 16, 18-23; Brief of N. Am. Sec. Adm'rs Ass'n, Inc. ("NASAA Br."), at 13-17 & n.2. This argument has already been rejected by *Central Bank* and this Court's insider trading cases. In *Central Bank*, the Tenth Circuit had held that "the lack of a duty to disclose is not dispositive in this case." *First Interstate Bank of Denver, N.A.* v. *Pring*, 969 F.2d 891, 901 (10th Cir. 1992). The plaintiffs in *Central Bank* argued to this Court that the defendant could be liable without "a

preexisting duty to the victims of the fraud" because of "its participation in a concealed side agreement with the developer" to use an outdated appraisal in bringing a new bond offering to market. Brief for Respondents, No. 92-854, *available at* 1993 WL 407323, at *1-2, 7-8. Likewise, the SEC, as *amicus* in support of the *Central Bank* plaintiffs, said that the defendant engaged in "affirmative action, not merely silence or inaction." Brief for the United States as *Amicus Curiae*, No. 92-854 *available at* 1992 WL 12006433, at *5. This Court reversed, holding that "[a]s in earlier cases considering *conduct prohibited by § 10(b)*, we again conclude that the statute prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act." *Central Bank*, 511 U.S. at 177 (emphasis added).

Likewise in *O'Hagan*, this Court made clear that *conduct* by a defendant who did not speak to the market—trading on inside information—was "deceptive" under § 10(b) only when that defendant breached a duty to disclose. *See United States* v. *O'Hagan*, 521 U.S. 642, 660 (1997) ("[I]t was O'Hagan's failure to disclose his personal trading to [his client and law firm], *in breach of his duty to do so*, that made his *conduct* 'deceptive' within the meaning of § 10(b).") (emphasis added; alterations in original omitted).[6]

Petitioner incorrectly argues that a duty to disclose requirement would exclude "conduct" from § 10(b) and

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[6] This Court also has held that common law concealment and suppression require a duty to disclose. *Strong* v. *Repide*, 213 U.S. 419, 430 (1909) ("concealment is equivalent to misrepresentation" by insider purchasing stock from minority shareholder where "it was the *duty* of the party who obtained the consent, acting in good faith, *to have disclosed* the facts which he concealed") (emphasis added), *cited in Chiarella*, 445 U.S. at 228 n.10; *Stewart* v. *Wyoming Cattle-Ranche Co.*, 128 U.S. 383, 388 (1888) ("if, with intent to deceive, either party to a contract of sale conceals or suppresses a material fact which he is in good faith *bound to disclose*, this is evidence of and equivalent to a false representation") (emphasis added).

render subsections (a) and (c) of Rule 10b-5 a nullity. *See, e.g.*, Pet. Br. at 24. Liability when a silent defendant breaches a duty to disclose does not arise under Rule 10b-5(b) because that subpart addresses only speaking defendants. Specifically, Rule 10b-5(b) applies only when a defendant "make[s] any untrue *statement* of material fact" and "omit[s] to state a material fact necessary in order to make *the statements made*, in light of the circumstances under which they were made, not misleading," *i.e.*, half-truths. (Emphasis added.) In contrast, Rule 10b-5(a) and (c) apply to at least four kinds of actionable conduct by non-speaking defendants—demonstrative conduct (*e.g.*, nodding assent at a press conference), omitting to disclose conduct by a party with a duty to disclose, insider trading, and market manipulation. Indeed, this Court's cases dealing with breach of a duty to disclose and insider trading have frequently arisen under Rule 10b-5(a) and (c). *See, e.g., O'Hagan*, 521 U.S. at 651; *SEC* v. *Zandford*, 535 U.S. 813, 819 (2002); *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 152-53 (1972).

Section 10(b) does not proscribe deceptive conduct in the abstract, however. To "use or employ" a deceptive device within the meaning of § 10(b), a defendant must actually mislead someone. *See O'Hagan*, 521 U.S. at 655, 659 n.9, 660. In a private civil case, that someone must be the plaintiff. Private civil liability statutes, including the implied cause of action under § 10(b), incorporate the general principle that a plaintiff must show not merely a violation of law, but breach of a legal duty owed *to that specific plaintiff*. *See, e.g., Bangor Punta Operations, Inc.* v. *Bangor & Aroostook R.R.*, 417 U.S. 703, 716 n.13 (1974) ("the recovery provided is intended to compensate, not the public generally, but those who have been injured by a breach of *duty owed to them*") (emphasis added); *Foss* v. *Bear, Stearns & Co.*, 394 F.3d 540, 541 (7th Cir. 2005) (Easterbrook, J.) (§ 10(b) private civil claim requires deceit against the plaintiff); *Moss* v. *Morgan Stanley, Inc.*, 719 F.2d 5, 13, 16 (2d Cir. 1983)

(although investment bank employee was criminally convicted for § 10(b) insider trading because of breach of duty to his employer and its client, a tender offeror, shareholders in target company had no § 10(b) claim because "'[t]here is no "duty in the air" to which any plaintiff can attach his claim.'") (citation omitted); *see also Cipollone* v. *Liggett Group, Inc.*, 505 U.S. 504, 522 (1992) (plurality opinion) (citing *Black's Law Dictionary* 1489 (6th ed. 1990) as "defining 'tort' as 'always [involving] a violation of some duty, *owing to plaintiff*'") (emphasis added; alteration in original).

Commercial counterparties do not have or breach any duty to the issuer's investors. Any deception used or employed against those shareholders comes from the accounting of the issuer (which has a duty to disclose), not from the transaction of the counterparty (which does not). If Charter's accounting had expensed rather than capitalized the increase in the prices for set-top boxes, there would be no alleged deception. A commercial counterparty has no relationship with the issuer's investors and thus no duty to disclose. In those circumstances, there is no implied private civil liability under § 10(b).

II. THE IMPLIED CAUSE OF ACTION UNDER § 10(b) SHOULD NOT BE EXTENDED TO ENCOMPASS "SCHEME" LIABILITY.

The Petitioner's question presented broadly asks whether *Central Bank* "forecloses claims under § 10(b)" and merely assumes that "Respondents engaged in their own deceptive conduct." Pet. Br. at *i*. Indeed, Petitioner expressly asks the Court to decide whether "scheme" liability satisfies the elements of reliance and causation necessary for private civil claims under § 10(b). *Id.* at 37-40. The Court should address the broader question of whether "scheme" liability is a basis for primary liability under the § 10(b) implied cause of action, and not only whether a commercial counterparty's participation in a commercial transaction could constitute

"deceptive" conduct in the abstract. Rejection of the broader argument is vital to the competitiveness of American businesses. *See supra*, at 6-8. *Central Bank* itself addressed reliance, which is an element of only the implied cause of action. *See* 511 U.S. at 180.[7]

Of course, if the statutory language precludes "scheme" liability, that is the end of the matter. But when the statutory language is not dispositive, the Court should limit the implied § 10(b) action to ensure that this "judicial oak" does not grow even further afield from the "legislative acorn." *Blue Chip*, 421 U.S. at 737; *see also Virginia Bankshares, Inc.* v. *Sandberg*, 501 U.S. 1083, 1102 (1991) ("the breadth of the [implied private] right once recognized should not, as a general matter, grow beyond the scope congressionally intended").[8] As *Blue Chip* held: "We are dealing with a private cause of action which has been judicially found to exist, and which will have to be judicially delimited . . . ." 421 U.S. at 749. Thus, even assuming that the SEC or Justice Department could bring a claim that a "sham" transaction by a commercial counterparty was a "deceptive" act, § 10(b) has no language suggesting that private plaintiffs could sue that commercial counterparty. *Id.* ("No language in either of [§ 10(b) or Rule 10b-5] speaks at all to the contours of a private cause of action . . . ."); *see Lampf, Pleva, Lipkin, Prupis & Pettigrow* v. *Gilbertson*, 501 U.S. 350, 359 (1991) ("We have made no pretense that it was Congress's design to provide the remedy afforded.").

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[7] The reliance holding in *Central Bank* reflects "a longstanding limitation on private § 10(b) suits" that does not apply to "criminal liability." *O'Hagan*, 521 U.S. at 664. Similarly, reliance need not be proven in SEC administrative actions under § 10(b). *See, e.g., SEC* v. *Credit Bancorp, Ltd.*, 195 F. Supp. 2d 475, 490-91 (S.D.N.Y. 2002).

[8] *Cf.* 501 U.S. at 1110 (Scalia, J., concurring) (when "the federal cause of action at issue here was never enacted by Congress . . . the more narrow we make it (within the bounds of rationality) the more faithful we are to our task") (citation omitted).

Moreover, this Court's approach is "to construe statutes, not isolated provisions." *Gustafson* v. *Alloyd Co.*, 513 U.S. 561, 568 (1995). In particular, the Court has cabined the implied § 10(b) cause of action so that it does not render superfluous the restrictions in other provisions of the 1933 and 1934 Acts. *See, e.g., Central Bank*, 511 U.S. at 178-79 ("we use the express causes of action in the Securities Acts as the primary model for the § 10(b) action"); *id.* at 182-83; *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 206-10 (1976); *Blue Chip*, 421 U.S. at 736. Examination of the provisions of the 1933 and 1934 Acts shows that the § 10(b) implied action should not be extended to create private civil claims for "scheme" liability. First, it would improperly override the limits on the express civil claims created by Congress. Second, it would undo Congressional decisions that only the SEC and the Justice Department may sue defendants for participating in a scheme. "The fact that Congress chose to impose some forms of secondary liability, but not others, indicates a deliberate congressional choice with which the courts should not interfere." *Central Bank*, 511 U.S. at 184. Third, "scheme" liability does not satisfy the established reliance and loss causation elements necessary for primary liability in a § 10(b) private cause of action.

A. "Scheme" Liability Would Nullify Statutory Restrictions On The Express Private Rights Of Action In The 1933 And 1934 Acts.

One statutory provision should not be interpreted to render another provision a "practical nullity." *United Sav. Ass'n* v. *Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 375 (1988). Thus, this Court will not "expand the defendant class for 10b-5 actions beyond the bounds delineated for comparable express causes of action." *Central Bank*, 511 U.S. at 180; *see also Virginia Bankshares*, 501 U.S. at 1104 ("we would have trouble inferring any congressional urgency to depend on implied private actions to deter violations of § 14(a), when Congress expressly provided private rights of action in

§§ 9(e), 16(b), and 18(a) of the same Act"). Private civil "scheme" liability under § 10(b) violates this principle.

1. § 18(a): Congress addressed in § 18(a) of the 1934 Act, not § 10(b), when a silent defendant should face private civil liability based on another defendant's misstatement or omission. Ignoring § 18(a), however, the proponents of "scheme" liability seek to imply into § 10(b) a cause of action that holds one defendant, usually a commercial counterparty, liable because another defendant, usually the issuer, makes a misstatement or material omission to the market.

Section 18(a) imposes liability on a defendant who "shall make *or cause to be made*" a statement that is "false or misleading with respect to any material fact" in "any application, report or document filed" pursuant to the 1934 Act, including the financial statements at issue here. 15 U.S.C. § 78r(a). In contrast, in § 10(b), Congress did not prohibit "causing" a deceptive device—*e.g.*, causing an issuer's misrepresentation in its financial statements—but instead stopped at the defendant who actually "use[s] or employ[s]" the deceptive device in connection with a purchase or sale of securities.

Although § 18(a) reaches a broader array of defendants than § 10(b), Congress imposed a critical limitation to preclude open-ended damages awards to the market as a whole: the plaintiff must have actually read and relied upon the misstatement. Section 18(a) limits potential plaintiffs to "any person . . . who, *in reliance upon such statement*, shall have purchased or sold a security at a price which was affected by such statement, for damages *caused by such reliance*." *Id.* (emphasis added). Because the statute expressly refers to the plaintiff's reliance on the specific statement – in addition to the requirement of an effect on the market price – it can be satisfied only by proof of individual reliance, rather than by the fraud-on-the-market presumption. *See, e.g., In re Suprema Specialties, Inc. Sec. Litig.*, 438 F.3d

256, 283-84 (3d Cir. 2006); *Heit* v. *Weitzen*, 402 F.2d 909, 916 (2d Cir. 1968).[9]

By contrast, in private § 10(b) actions, the reliance requirement is not a statutory creation but rather was judicially implied to delimit the implied cause of action. *See Basic, Inc.* v. *Levinson*, 485 U.S. 224, 243 (1988). Allowing fraud on the market to satisfy reliance in a § 10(b) action does not render § 18(a) a practical nullity *only* because the class of defendants that can be sued in a § 10(b) private civil action is narrower than the group that can be sued in the express § 18(a) action. "Scheme" liability obliterates that essential limitation. No private plaintiff would sue a secondary actor under § 18(a), which requires actual reliance, if "scheme" liability allows a § 10(b) claim against the same defendant for causing a misstatement *without* proving actual reliance. Indeed, this is why petitioner, like all other plaintiffs alleging scheme liability, did not sue under § 18(a), even though petitioner describes "[t]he scheme to defraud here" as "causing false financial statements to be published." Pet. Br. 21-22. That fact speaks volumes about the improper nullifying impact petitioner's § 10(b) theory would have on § 18(a). *See United Sav.*, 484 U.S. at 375.

2. § 9(e): Like § 18(a), § 9(e) reaches beyond defendants who use or employ the specified unlawful devices. Section 9(a)-(c) prohibits certain enumerated forms of market manipulation, and § 9(a)(4) also prohibits false or misleading statements by a dealer, broker, "or the person selling or

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[9] An earlier proposed version of § 18(a) required only that the market price of the security be affected by the misstatement. That provision was amended to add the additional requirement of "eyeball" reliance in response to criticism of the potentially sweeping liabilities under the earlier proposal. *See* Barbara Black, *Fraud on the Market: A Criticism of Dispensing with Reliance Requirements in Certain Open Market Transactions*, 62 N.C. L. Rev. 435, 464-65 & nn.191 & 192 (1984). *Accord In re MDC Holdings Sec. Litig.*, 754 F. Supp. 785, 798 (S.D. Cal. 1990); *Hoover* v. *Allen*, 241 F. Supp. 213, 221-23 (S.D.N.Y. 1965).

offering [a security] for sale" made "for the purpose of inducing the purchase or sale" of that security. 15 U.S.C. § 78i(a)-(c). Unlike § 10(b), § 9(e) creates additional express private civil liability for "[a]ny person who *willfully participates in* any act or transaction" prohibited by §§ 9(a)-(c). 15 U.S.C. § 78i(e) (emphasis added). As *Pinter*, 486 U.S. at 650 n.26, held, § 9(e) shows "Congress knew of the collateral participation concept" and thus that concept should not be implied into other civil liability provisions. Nonetheless, even the class of defendants under § 9(e) does not include "one who aids or abets a violation." *See Central Bank*, 511 U.S. at 179.

"Scheme liability" would improperly render important restrictions on the express § 9(e) action meaningless, by creating instead a more easily satisfied § 10(b) implied action. For example, § 9 is limited to specified manipulative practices and a narrow class of false or misleading statements made directly between buyers and sellers of securities, *see, e.g.*, *Robbins* v. *Banner Indus., Inc.*, 285 F. Supp. 758, 761 (S.D.N.Y. 1966), for the specific "purpose of inducing the purchase or sale" of the specific security purchased or sold by the defendant. 15 U.S.C. § 78i(a)(4). Thus, unlike § 10(b), a purchaser in the secondary market could not sue even an issuer under § 9 over its periodic financial reports. *See Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d 783, 788 (2d Cir. 1951) (§ 9(a)(4) "impose[s] restrictions somewhat like those imposed on a suit under § 11 of the 1933 Act").

3. §§ 11 and 12 of the 1933 Act: Section 11 of the 1933 Act creates a claim against only enumerated defendants – directors of the issuer, underwriters, and those who sign or consent to be named in a registration statement – for misrepresentations or omissions in a registration statement for an offering of new securities. *See* 15 U.S.C. § 77k(a). It does not apply to others who cause or assist misstatements by the enumerated defendants. *See Central Bank*, 511 U.S. at 179.

Sections 12(a)(1) and 12(a)(2) claims are directed against anyone who "[o]ffers or sells a security . . . by means of a prospectus or oral communication" that is false or misleading, or in violation of registration requirements, to be sued by "the person purchasing such security from him." 15 U.S.C. § 77*l*(a)(1)-(2). The class of defendants is again limited, to those in privity with the plaintiff or who directly solicit the plaintiff's purchase at least in part for their own financial gain. This Court rejected extending § 12 liability to someone "'whose participation in the buy-sell [securities] transaction is a substantial factor in causing the transaction to take place.'" *Pinter*, 486 U.S. at 649; *see Central Bank*, 511 U.S. at 179. An implied cause of action for "scheme" liability under § 10(b) against companies engaged in commercial transactions with the issuer or seller would undo Congress's policy choices limiting §§ 11 and 12 claims.[10]

B. "Scheme" Liability Would Nullify Statutory Provisions Intended To Be Enforceable Only By The Government.

In stark contrast, other provisions of the 1933 and 1934 Acts allow *only* the SEC and the Justice Department, *not* private litigants, to sue the very defendants targeted by private "scheme" liability. Petitioner's argument would obliterate these policy decisions made by Congress.

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[10] *Herman & MacLean* v. *Huddleston*, 459 U.S. 375 (1983), does not suggest otherwise. That case involved a § 10(b) claim against an accounting firm for its own allegedly false statements. *See id.* at 377. In a footnote, dictum suggests that § 10(b) may apply to "*certain* individuals who play a part in *preparing* the registration statement." *Id.* at 386 n.22 (emphases added). A person that plays a "part in preparing" a false registration statement may arguably be "using or employing" that false statement under § 10(b). But commercial counterparties play no "part in *preparing*" the issuer's financial statements, and that is not the theory of "scheme" liability. Rather, "scheme" liability rests on the assertion that the implied § 10(b) action extends to the commercial counterparty's undisclosed transaction itself. Nothing in *Herman & MacLean* remotely supports that.

1. Provisions Of The Original 1933 And 1934 Acts: When Congress wanted to create liability for employing fraudulent "schemes," it did so expressly. Section 17(a) of the 1933 Act thus renders it unlawful "to employ any device, *scheme*, or artifice to defraud, or . . . to engage in any *transaction*, practice, or *course of business* which operates or would operate as a fraud or deceit upon the purchaser." 15 U.S.C. § 77q(a)(1), (3) (emphasis added). Thus, unlike § 10(b), subparts (1) and (3) of § 17(a) expressly cover defendants who employ a scheme or engage in a course of business, rather than use or employ a deceptive device itself.[11]

Section 17(a) reaches any sale in the primary and secondary markets. *See Gustafson*, 513 U.S. at 577-78; *United States* v. *Naftalin*, 441 U.S. 768, 777-78 (1979). The SEC has regularly used § 17(a) against secondary actors, *see, e.g.*,

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[11] It is particularly inappropriate to construe § 10(b) or Rule 10b-5 as if § 10(b) had used language included in § 17(a) but *omitted* from § 10(b). *See Central Bank*, 511 U.S. at 179-80, 184. The reach of Rule 10b-5 is limited by § 10(b). *See, e.g., Santa Fe Indus.*, 430 U.S. at 473-74 (a "complaint states a cause of action under any part of Rule 10b-5 *only if* the conduct alleged can be fairly viewed as 'manipulative or deceptive' within the meaning of the statute") (emphasis added); *Hochfelder*, 425 U.S. at 213-14 (Rule 10b-5's "scope cannot exceed the power granted the [SEC] by Congress under § 10(b)"). This limit applies even when Rule 10b-5 uses the same language as § 17(a). *Compare Aaron* v. *SEC*, 446 U.S. 680, 695-97 (1980) (scienter not required under §§ 17(a)(2) & (3)), *with Hochfelder*, 425 U.S. at 212-14 (scienter required for all § 10(b) actions despite use of same language in Rule 10b-5(b) & (c) as in §§ 17(a)(2) & (3)). Moreover, the administrative history of Rule 10b-5 shows that it was promulgated merely to clarify that the SEC could sue defrauding purchasers in addition to defrauding sellers of stock. *See Hochfelder*, 425 U.S. at 212 n.32; *Blue Chip Stamps*, 421 U.S. at 766-67 (Blackmun, J., dissenting); Milton V. Freeman, *Administrative Procedures*, 22 Bus. Law. 891, 922 (1967); Milton V. Freeman, *Foreword*, 61 Fordham L. Rev. S1, S1-S2 (1993). There was no intent to create a private cause of action, much less one against secondary actors. *See Hochfelder*, 425 U.S. at 196 ("there is no indication that Congress or the Commission when adopting Rule 10b-5, contemplated such a remedy").

Weiss v. *SEC*, 468 F.3d 849, 855-56 (D.C. Cir. 2006), and against fraudulent schemes. *See, e.g., In re Schmidt*, Rel. No. 8061, 2002 WL 89028, at *7-8 (S.E.C. Jan. 24, 2002).

Most important for this case, § 17(a) does *not* create a private right of action. *See, e.g., Finkel* v. *Stratton Corp.*, 962 F.2d 169, 175 (2d Cir. 1992) (citing cases). If Congress wanted private civil claims for "scheme" liability, it would have provided an express cause of action for § 17(a) claims, just as it did for the express but narrower §§ 11 and 12 claims. It did not. Instead, § 17(a)'s sweeping prohibitions are bounded by the SEC's and the Justice Department's sound prosecutorial discretion, which ensures a focus on genuinely serious wrongdoing and the public interest. This is in marked contrast to the pursuit of private remedies, where the private plaintiffs' bar has a powerful economic incentive to sue everyone. The detrimental effect of those incentives on the competitiveness of American business is obvious: in the last decade, even *after* the PSLRA, 2,465 issuers have been named as defendants in securities fraud class actions out of approximately 6000 companies listed on the major U.S. exchanges. *See Final Report*, at 30. "Scheme" liability would cause those already astounding numbers to multiply, given that all companies do business with other companies.[12]

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[12] Like § 17(a), other provisions of the 1933 and 1934 Acts also expressly authorize the government, but *not* private civil plaintiffs, to pursue a variety of secondary actors. The 1934 Act grants the SEC express statutory authority to pursue registered broker-dealers and their "associated persons" who "willfully aided, abetted, counseled, commanded, induced, or procured" violations of the securities laws. 15 U.S.C. §§ 78o(b)(4)(E), 78u-2(a)(2). *See also Central Bank*, 511 U.S. at 183. The SEC also can sue ongoing and future violators of the securities laws "and any other person that is, was, or would be *a cause* of the violation, due to an act or omission the person knew or should have known would *contribute* to such violation." 15 U.S.C. § 78u-3(a) (emphasis added). The SEC and Justice Department also can pursue those who "made or caused to be made" false statements in required filings or

2. § 20(e): In the Private Securities Litigation Reform Act of 1995 (PSLRA), Congress rejected proposals to overrule *Central Bank* and expand the scope of private civil liability under § 10(b) to secondary actors. Instead, in enacting § 20(e) of the 1934 Act, 15 U.S.C. § 78t(e), Congress expressly provided that *only* in actions brought by the SEC, "any person who knowingly provides substantial assistance to another person in violation of a provision of this chapter, or of any rule or regulation issued under this chapter, shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided." Thus, Congress gave the SEC, but *not* private plaintiffs, an express claim for conduct ("substantial assistance") against defendants who had no duty to disclose.

This congressional decision has only one of two meanings. Either Congress chose to ratify the *Central Bank* holding, *supra*, at 9-11, that *private* plaintiffs could not sue defendants under § 10(b) for conduct when those defendants had no duty to disclose. Or, as petitioner and its amici would have it, Congress believed that what was called "aiding-and-abetting" conduct before *Central Bank* would be called "primary" conduct thereafter, so that there was no need to overrule *Central Bank* for private plaintiffs. The latter view is nonsensical and contradicts the PSLRA's drafting history.

If the scope of primary liability under § 10(b) were as broad as petitioner contends, then § 20(e) would be at best surplusage. The SEC would always sue for "scheme" liability under § 10(b) because § 20(e) has additional requirements of "knowingly providing substantial assistance."

Moreover, as the Senate Report states, Congress made a deliberate policy decision to deny private plaintiffs the authority to bring suits for conduct against secondary actors who had no duty to disclose because "amending the 1934 Act

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broker-dealer registrations. *See* 15 U.S.C. §§ 78o(b)(4)(A), 78u-2(a)(3), 78ff(a). None of these provisions creates a private right of action.

to provide explicitly for private aiding and abetting liability actions under Section 10(b) would be contrary to [the] goal of reducing meritless securities litigation." S. Rep. No. 104-98, at 19 (1995). There is no hint that the same claims could proceed simply by relabelling them as claims for primary conduct. To the contrary, in the PSLRA, Congress sought to avoid the kinds of chilling effects caused by litigation risk that "scheme" liability claims in private class actions would create. *See* H.R. Rep. No. 104-50, at 20 (1995) ("Fear of litigation keeps companies out of the capital markets."); *see also* 143 Cong. Rec. S10475, S10477 (daily ed. Oct. 7, 1997) ("if our markets are to remain ahead of those in London, Frankfurt, Tokyo, or Hong Kong, we must create uniformity and certainty"); *supra*, at 6-8.

More generally, Congress is presumed to know the law when it legislates. *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, 456 U.S. 353, 379 (1982). Thus, Congress knows that "[a]s a general rule, the principle of *stare decisis* directs [this Court] to adhere not only to the holdings of [its] prior cases, but also their explications of the governing rules of law." *County of Allegheny* v. *ACLU*, 492 U.S. 573, 668 (1989) (Kennedy, J., concurring); *see also Carey* v. *Musladin*, 127 S. Ct. 649, 655 (2006) (Stevens, J., concurring) (*stare decisis* includes "explanatory language" for the Court's ruling even if "such guidance . . . may not have been strictly necessary as an explanation of the Court's specific holding").

Central Bank explicated why aiding-and-abetting was inconsistent with the necessary elements for primary liability. First, *Central Bank* held: "As in earlier cases considering *conduct* prohibited by § 10(b), we again conclude that the statute prohibits *only* the making of a material misstatement (or omission) or the commission of a manipulative act." 511 U.S. at 177 (emphasis added). Commercial counterparties do not make statements to the market about the issuer or have the duty to disclose necessary for liability for a material omission.

Second, *Central Bank* held that defendant-by-defendant reliance is an essential element of primary liability:

> [R]espondents' argument would impose 10b-5 aiding and abetting liability when at least one element critical for recovery under 10b-5 is absent: reliance. A plaintiff must show reliance on *the defendant's misstatement or omission* to recover under 10b-5. Were we to allow the aiding and abetting action proposed in this case, *the defendant* could be liable without any showing that the plaintiff relied upon *the aider and abettor's* statements or actions. Allowing plaintiffs to circumvent the reliance requirement would disregard the careful limits on 10b-5 recovery mandated by our earlier cases.

Id. at 180 (emphasis added; citations omitted). As we show *infra*, at 28-29, "scheme" liability cannot be reconciled with the defendant-by-defendant reliance required by *Central Bank*.

Less than a month after *Central Bank* was issued on April 19, 1994, then-SEC Chairman Levitt told Congress that *Central Bank* required defendant-by-defendant reliance under § 10(b): "As the Supreme Court emphasized in *Central Bank of Denver*, a private plaintiff under Rule 10b-5 must show, *defendant by defendant*, that the plaintiff reasonably relied on the defendant's misstatement or omission." *Abandonment of the Private Right of Action for Aiding and Abetting Securities Fraud/Staff Report on Private Securities Litigation: Hearing Before the Subcomm. on Sec. of the S. Comm. on Banking, Hous., & Urban Affairs*, 103d Cong. 51 (1994) (statement of Arthur Levitt, Chairman, SEC) (emphasis added). And, former SEC Chairman David Ruder told Congress that "[a]ctive assistance to securities law fraud by accountants, banks, lawyers and others who cannot be classified as participants or controlling persons would no longer be actionable." *Id.* at 107. Congress chose not to overrule either *Central Bank*'s definition of the scope of § 10(b) liability or its requirement of defendant-by-defendant reliance.

To the contrary, in the PSLRA, Congress adopted the principle of *Central Bank* that elements of § 10(b) primary liability must be satisfied by reference to the conduct of the particular defendant. Specifically, the PSLRA required that "the act or omission *of the defendant* alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages." 15 U.S.C. § 78u-4(b)(4) (emphasis added). As we show *infra*, at 29-30, "scheme" liability cannot be reconciled with defendant-by-defendant loss causation.

3. Sarbanes-Oxley: In the Sarbanes-Oxley Act enacted in 2002, Congress again rejected allowing private civil plaintiffs to use § 10(b) to sue secondary actors. Members of Congress proposed "to give the victims of fraud the right to sue those who aid issuers in misleading and defrauding the public." H.R. Rep. No. 107-414, at 53 (2002). Congress was urged to "undo the Central Bank case and bring back aiding and abetting." *Hearing on H.R. 3763 Before the H. Comm. on Fin. Servs.*, 107th Cong. 63 (2002).[13] It was broadly asserted that "when a person adds substantial value to a fraudulent course of conduct—in other words, contributes in a substantive way to its success—then liability is necessary and appropriate to achieve both deterrence and compensation." *Id.* at 485-86. Congress rejected these proposals for expanding the § 10(b) implied private cause of action. Instead, Congress empowered *the SEC* to direct to shareholders any proceeds it obtained from the secondary actors it sued under § 20(e). 15 U.S.C. § 7246(a). From 2002 to 2006, the SEC recovered $8 billion, including from aiders

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[13] Former Senator Metzenbaum proposed "to restore aiding and abetting liability for those who contribute to fraud but are not the primary culprit." *Accounting and Investor Protection Issues Raised by Enron and Other Public Companies: Hearing Before the S. Comm. on Banking, Hous., & Urban Affairs*, 107th Cong. 1037 (2002). Senators Shelby and Durbin proposed to create express private liability against "persons that aid or abet violations" of § 10(b) of the 1934 Act. 148 Cong. Rec. S6584 (daily ed. July 10, 2002).

and abettors, for distribution to shareholders. See SEC, *2006 Performance and Accountability Report* 23 (Nov. 2006), *available at* http://www.sec.gov/about/secpar2006.shtml. *See also Interim Report*, at 71 ("The United States has the toughest administrative enforcement of securities laws in the world.")[14]

Congress's repeated decisions not to modify *Central Bank* in private civil suits is at least "entitled to a good deal of weight." *Blue Chip*, 421 U.S. at 749. Indeed, "[i]t is the federal lawmaker's prerogative . . . to . . . shape the contours of . . . § 10(b) private actions." *Tellabs*, 127 S. Ct. at 2512. Legislative acquiescence is particularly strong here because, "[o]nly one month after" *Central Bank* was decided "Congress held its first hearings on this precise issue. Exhaustive hearings have been held on the issue at various times since then[;]" and Congress has rejected various bills to overrule *Central Bank*. *Bob Jones Univ.* v. *United States*, 461 U.S. 574, 600-01 (1983). "In view of its prolonged and acute awareness of so important an issue," *id.*, Congress has decided that *Central Bank* provides the proper rule of decision in § 10(b) private actions.

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[14] As petitioner and its *amici* note, the 1933 and 1934 Acts refer in several places explicitly to misrepresentations, omissions, conduct, and acts rather than to a "manipulative or deceptive device or contrivance." Petitioner and its *amici* incorrectly contend that these references prove that Congress intended the language of § 10(b) to cover "scheme" liability. Pet. Br. at 18-21; Regents Br. at 17-20, 24; Ohio Br. at 15-20; Ark. Br. at 12-14. This argument is a red herring. No one disputes that § 10(b) applies to "conduct." But for a § 10(b) private civil claim to be based on conduct, the conduct must itself be "deceptive or manipulative" and satisfy "*all* of the requirements for primary liability under Rule 10b-5." *Central Bank*, 511 U.S. at 191. Petitioner and its *amici* contend that participating in a "scheme" is "deceptive" conduct. Nothing in any of the statutory provisions cited by petitioner or its *amici* addresses, expressly or implicitly, whether participating in a "scheme" constitutes "deceptive" conduct under § 10(b), or satisfies the other requirements for primary liability, such as reliance and loss causation. Those provisions are therefore irrelevant.

C. "Scheme" Liability Cannot Be Reconciled With The Elements Of Primary Liability In A § 10(b) Cause Of Action.

Central Bank holds: "Any person or entity, including a lawyer, accountant, or bank, *who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies* may be liable as a primary violator under 10b-5, assuming *all* of the requirements for primary liability under Rule 10b-5 are met." 511 U.S. at 191 (first emphasis added). As *Central Bank* describes, the line between private primary liability and aiding-and-abetting requires that the deceptive "device or contrivance" used or employed by the particular defendant itself satisfy *all* of the requirements for § 10(b) primary liability. A plaintiff cannot mix and match (1) one device or contrivance used or employed by defendant A to satisfy the deception element against defendant A with (2) defendant B's different device or contrivance to satisfy the *other* elements of primary liability against defendant A, including reliance.

In particular, when a commercial counterparty's allegedly deceptive conduct or statements to third parties other than investors merely assist, enable, or otherwise cause an issuer's misstatement, and the reliance, causation, and other elements are satisfied only by the issuer's misstatement, the defendant has committed only aiding and abetting. *See Wright* v. *Ernst & Young LLP*, 152 F.3d 169, 173-76 (2d Cir. 1998) (because investors did not rely on auditor's false but undisclosed statement to issuer that issuer's financial results were accurate, auditor's statement constituted aiding and abetting, not primary liability); *Filler* v. *Hanvit Bank*, 156 F. App'x 413, 415-16 (2d Cir. 2005) (summary order) (although banks sent "false loan confirmations" to auditor, investors did not rely on these).

1. "Scheme" Liability Is Incompatible With *Central Bank*'s Reliance Requirement.

Even when a defendant has used or employed a deceptive device, such as a misstatement, but that statement is *not* disclosed to investors, the defendant itself has not made "a material misstatement (or omission) *on which a purchaser or seller of securities relies*." *Central Bank*, 511 U.S. at 191 (emphasis added). Under *Central Bank*, reliance upon the public statements of issuers and auditors is insufficient to satisfy the reliance element to hold a different, silent defendant liable as a primary violator. *See id.* at 180 ("A plaintiff must show reliance on *the defendant's misstatement or omission* to recover under 10b-5."). Lack of reliance on a secondary actor is no different just because the defendant is relabeled from an aider and abettor to a schemer. Such a defendant's conduct or statements are still unknown to the plaintiff and the market and that defendant still has no relationship that creates a duty to disclose.[15]

The fraud on the market doctrine is of no assistance in establishing reliance against "scheme" liability defendants. That doctrine applies only to "publicly available information" from the defendant. *Basic*, 485 U.S. at 247; *see Dinsmore* v. *Squadron, Ellenoff, Plesent, Sheinfeld & Sorkin*, 135 F.3d 837, 843 (2d Cir. 1998) (investors did not rely on attorneys' misrepresentations to SEC that were not public). The

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[15] As *Central Bank* recognized, 511 U.S. at 177, 180, it would be particularly inappropriate to apply the word "indirectly" from the preamble to § 10 to make the reliance requirement easier to satisfy in a § 10(b) private damages action. The reliance requirement does not arise from the language of § 10(b) and thus does not apply when the SEC sues. *Supra*, at 14 & n.17. Rather, the courts created a reliance requirement to keep the judicially implied private damages action within "careful limits." *Central Bank*, 511 U.S. at 180. It would be improper to apply the "indirectly" language of § 10(b) to weaken the important reliance limit on the private damages action when the language of § 10(b) does not itself create a private damages action in the first place.

transactions of commercial counterparties would normally not be publicly available information. *Stoneridge* illustrates this. The market knew about Charter's financial statements but was unaware of any conduct by respondents.

2. "Scheme" Liability Is Incompatible With The PSLRA's Loss Causation Requirement.

As noted above, the PSLRA requires that the plaintiff allege and prove that "the *act or omission of the defendant* alleged to violate this chapter caused the loss." 15 U.S.C. § 78u-4(b)(4). Loss causation is satisfied only when the issuer's stock price declined because of the particular defendant's deceptive act or omission. *Dura*, 544 U.S. at 344; *see also Lattanzio* v. *Deloitte & Touche LLP*, 476 F.3d 147, 158 (2d Cir. 2007) (plaintiffs "have not alleged facts to show that *Deloitte's misstatements*, among others (made by Warnaco) that were much more consequential and numerous, were the proximate cause of plaintiffs' loss") (emphasis added).

In this case, as in other commercial counterparty cases, the "act or omission of the defendant" vendors was never disclosed to either inflate or deflate the market price of the issuer's stock. Nonetheless, petitioner alleges that *Charter's* much broader "*financial statements* caused the price of Charter's stock to be inflated" and that respondents should be held responsible for all $7 billion in damages flowing from Charter's financial statements, Pet. Br. at 38, even though respondents' transactions allegedly increased operating cash flow by only $17 million. Scientific-Atlanta Cert. Opp. App. at 33 (Am. Cmpl. ¶ 79.) Because Charter's statements and omissions were not "the act or omission *of the defendant*" respondents, the PSLRA loss causation requirement is not satisfied.

This is confirmed by *Dura*, which held that loss causation is at least as demanding as common law proximate cause. *See*

544 U.S. at 343-44. The common law requires "a direct causal connection." *Anza* v. *Ideal Steel Supply Corp.*, 126 S. Ct. 1991, 1996-98 (2006). "Scheme" liability, however, seeks to hold a commercial counterparty liable because (a) its commercial transaction was (b) improperly accounted for by the issuer in (c) the issuer's much broader financial statements, and (d) those broader financial statements inflated the issuer's stock price. That is the antithesis of "a direct causal connection." *Cf. Holmes* v. *SIPC*, 503 U.S. 258, 287 (1992) (Scalia, J., concurring) ("'for want of a nail, a kingdom was lost' is a commentary on fate, not the statement of a major cause of action against a blacksmith"). Rather, it is classic aiding-and-abetting. Thus, under *Central Bank*, it provides no basis for a claim under the § 10(b) implied action.

CONCLUSION

The decision of the court of appeals should be affirmed.

Respectfully submitted,

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